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DOING BUSINESS IN CANADA

TAXATION INCOME, BUSINESS, PROPERTY

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FOREWORD

The information in this booklet deals with the incidence of taxation on income, business and property. It is intended as a guide in this field of taxation and, as such, refers only to the basic principles involved. Every effort has been made to accurately reflect the legislation in force at the time of preparing the material.

Since the law contains a considerable amount of detail, however, and since changes at all levels occur from time to time, it is suggested that an enquirer consult with relevant authorities or lawyers of his choice, or both, when seeking precise and detailed advice on a given problem.

While the Department of Industry, Trade and Commerce is prepared to assist manufacturers requiring guidance in these matters, specific information can be obtained from any one of the district taxation offices of Revenue Canada located throughout the country. Head Office of Revenue Canada is in Ottawa.

Other publications available in the "Doing Business in Canada" series are:

The Business Environment

Forms of Business Organization

Canadian Customs Duties

Taxation — Sales, Excise, Commodity

Labour Legislation

Construction and Equipment Standards

Federal Incentives to Industry

Patents, Trade Marks, Industrial Designs and Copyrights

Also available:

Financing Canadian Industries

Further information is available from:

The Business Centre
Department of Industry, Trade and Commerce
235 Queen Street
Ottawa, Ontario K1A 0H5
Tel.: 995-5771 (Area Code 613)
Telex: 053-4123
Long Distance: ZENITH 0-3200

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July 1978

FEDERAL-PROVINCIAL ARRANGEMENTS

There are three levels of taxation in Canada — federal, provincial and municipal. The federal government levies both direct and indirect taxes, the most important of which are the corporate and personal income taxes and the manufacturers' sales tax. The provincial governments levy direct taxes, such as income tax, retail sales tax, and succession duties. Municipalities function under the guidance of provincial legislation and impose direct taxes on real estate, water consumption and places of business.

Generally speaking, all individuals and corporations resident in Canada are liable to federal and provincial income taxes. These taxes are applied on income received or receivable during the taxation year from all sources inside or outside Canada, less certain deductions. Similarly, individuals and branches of foreign companies carrying on business in Canada are liable to Canadian income taxes on profits derived from these business operations.

Federal-provincial tax agreements, by which the federal government collects and remits to the provinces specified taxes, normally are re-negotiated every five years. Federal corporate income taxes are abated by 10 per cent for all provinces. Estate taxes no longer apply at the federal level, but Ontario and Quebec impose succession duties.

Income taxes imposed by the provinces are collected by the federal government, except in the cases of corporate income taxes imposed by the provinces of Quebec and Ontario, and personal income tax imposed by Quebec.

FEDERAL CORPORATION INCOME TAX

Generally speaking, all companies resident in Canada are liable to federal income tax. The tax is applied upon income received or receivable during the taxation year from all sources inside or outside of Canada less certain deductions permitted by the Income Tax Act.

"Income" is not defined in the federal Income Tax Act. The act merely states that it includes income for the year from all businesses, properties, offices and employment. One half of post-1971 capital gains is also included in income. Detailed instructions are not given on how to compute income but the Act contains rules specifically allowing certain expenses and denying a deduction to others. The computation of business income begins with financial statement income determined in accordance with generally accepted accounting principles. Adjustments are then made to this figure for specific matters covered under the Act.

The amount of tax payable is calculated by applying statutory rates of tax to taxable income which is the amount remaining after making certain deductions from income. The general rate has been 46 per cent since 1976. However, this rate may be reduced by a small business incentive or partially offset by refundable tax provisions for investment income of private corporations. It is further reduced by the provincial abatement of 10 per cent.

Corporations pay a special rate of 40 per cent on income derived from Canadian manufacturing and processing activities. Companies seeking guidance on how to distinguish manufacturing and processing income from income from other sources should contact Revenue Canada.

Small Business Incentive

The legislation provides a low rate of corporate tax aimed at direct assistance to small business. The rate is 25 per cent of the first $150,000 of business income (net profit) of Canadian-controlled private corporations earned in any one year, to a limit of $750,000 of taxable income accumulated and retained after the 1971 taxation year. It is not available on investment income or to public corporations, their subsidiaries, or foreign-controlled corporations. This rate is reduced to 20 per cent for income derived from Canadian manufacturing and processing operations.

A public corporation can be generally defined as a corporation whose shares are listed on a prescribed Canadian stock exchange, or a corporation that meets certain conditions and either is designated by the minister to be, or elects to be, a public corporation. A private corporation is, again generally speaking, any Canadian resident corporation that is not a public corporation or that is not controlled by one or more public corporations.

The legislation reserves the benefit of the in-

centive to small corporations by providing that as soon as $750,000 of taxable income has been accumulated, the low rate will no longer be available. To ensure that the low rate is not applied to more than $150,000 of annual business income by a group of related corporations, there is a set of rules for determining "associated" companies. Briefly, one corporation is associated with another if one of the corporations controls the other, or if both of the corporations are controlled by the same person. The maximum annual amount of $150,000 to which the low rate can be applied must be allocated within the group of companies, and the accumulated taxable income limit of $750,000 will be determined for the group as a whole.

Investment Income

For private corporations, investment income other than dividends (including things such as interest, rent, royalties and one-half of capital gains) is subject to the normal rate of corporate tax, 16 2/3 percentage points of which will be refunded to the corporation when dividends are paid to shareholders.

On dividends received from portfolio investments the tax is 25 per cent, which is fully refunded to the corporation when dividends are paid to shareholders. Dividends received by a private corporation from a subsidiary corporation or from certain private corporations in which it owns more than 10 per cent of the equity are tax-exempt.

A further feature is that one-half of capital gains realized by private corporations may be distributed tax-free to shareholders. When viewed together with the refundable tax provisions and dividend tax credit, this will result in approximately the same total taxes as if the shareholders had personally received the capital gain.

Most dividends received by public corporations are exempt from tax. Other investment income is taxed at the general rate.

Special rules are provided for the taxation of special purpose companies such as mutual fund corporations, life insurance companies and co-operatives. A corporation that qualifies as an "investment corporation" pays tax at a rate of only 33 1/3 per cent. This rate is also reduced by the provincial abatement.

Deductions

The Income Tax Act permits certain deductions in computing "income" and certain additional deductions in computing "taxable income." These notes do not distinguish between the two types of deductions. Among the deductions normally allowable are expenditures incurred for the purpose of earning income, including interest on money and rent for property used in earning income; reserves for doubtful debts; bad debts; contributions to employee pension funds; payments for unemployment insurance and workmen's compensation; expenditures on scientific research; patronage dividends; an allowance equal to 3 per cent of the value of opening inventory; and employer's contributions under profit-sharing plans. Certain special deductions, e.g. drilling and exploration expenditures and depletion allowances, are allowed in respect of income from oil wells, gas wells and mines.

Expenses incurred in the course of issuing or selling shares of its capital stock or in the course of borrowing money used in the company's business (other than amounts in respect of commissions, bonus payments and discounts) are also allowed as a deduction in computing the income of a company. Full deduction is allowed for interest paid on money borrowed to buy shares in other corporations. As a general rule one half of capital losses may be deducted from the capital gains included in income; unused capital losses may be carried back one year and forwarded indefinitely to be set against capital gains.

Of particular importance to a new company is a provision whereby profits and losses may be offset over a seven-year period. Business losses may be carried back one year or forward five years and deducted in computing taxable income.

Other expenditures not allowable as deductions include membership fees in recreational and social clubs; the expenses of a yacht, camp or lodge; sums transferred to a reserve or sinking fund unless expressly permitted; and, in general, any expense or outlay not made for purpose of earning income. Various entertainment and convention expenses are deductible within limits. Charitable donations are deductible up to a maximum of 20 per cent of income.

Goodwill and other intangible assets such as costs of incorporation are partially deductible. One half of their cost is deductible at a rate of 10 per cent on a declining balance. One half of the proceeds of sale of such assets must be included in income.

Capital Cost Allowances

A capital cost allowance is a deduction permitted in respect of the cost of depreciable capital

assets acquired for the purpose of producing income. Capital cost allowances are sometimes referred to as depreciation allowances. Assets are grouped into classes for the purpose of capital cost allowances and each class carries a maximum rate of annual write-off which is applied on a diminishing balance basis.

The maximum rates of capital cost allowance for classes of greater interest are as follows:

		Percentage
Frame buildings and component parts	—	10
Other buildings and component parts	—	5
Automobiles, trucks, etc.; mining machinery, equipment and buildings	—	30
Certain contractors' equipment for excavating or compacting earth, rock, concrete or asphalt	—	50
Production machinery	—	20
Sundry, not included in specific groups	—	20
Dies, jigs, patterns; tools costing less than $200	—	100

Machinery and equipment purchased after May 8, 1972, to be used for the manufacturing or processing of goods for sale or lease in Canada may be fully written off in two years with a maximum of 50 per cent of cost being claimable in the taxation year of acquisition.

Capital cost allowances are ordinarily calculated on a diminishing balance rather than a straight-line principle. For example, where a depreciable asset cost $10,000 and has a depreciation rate of 5 per cent, the amount deductible at the end of the first year would be $500 (5 per cent of $10,000), at the end of the second year $475 (5 per cent of $9,500), at the end of the third year $451.25 (5 per cent of $9,025), etc. The capital cost of new acquisitions of property is added to the balance in its class and the proceeds of disposition of property (except any part thereof in excess of original capital cost) is deducted from the balance in its class. If the result of such a deduction is that a class has a credit balance, the balance of the class is "recaptured" through an addition to income. Special rules limit deductions for losses created by a claim for capital cost allowance on certain categories of real estate rental property.

A lesser amount than the maximum may be claimed as a deduction if the taxpayer so chooses. It might be mentioned also that the amount claimed need not conform to the depreciation deducted in computing profits as shown on the financial statement to shareholders.

Accelerated depreciation (full write-off in two years) is allowed in respect of structures and equipment acquired before 1980 to prevent water and air pollution.

There are special capital allowances available to firms, qualified under the Area Development Program, which locate or expand in "designated areas." Further details on this program are available from the Department of Regional Economic Expansion, Ottawa, K1A 0M4.

Scientific Research

Income tax allowances for expenditures on scientific research have been growing in importance in recent years. The Income Tax Act allows any write-off up to 100 per cent of current and capital expenditures (other than land) for scientific research in Canada in the taxation year during which such expenditures were incurred. Any portion of the expense unclaimed in the year of expenditure may be carried forward to any later year. Scientific research and development expenditures are also eligible for the Investment Tax Credit.

For a period of 10 years, commencing on January 1, 1978, corporations carrying on business in Canada may also be entitled to a new research allowance. That new deduction is equal to 50 per cent of qualified expenditures on scientific research in Canada in excess of the average of such expenditures in a base period. As a general rule, the base period is the preceding three years.

For this purpose, scientific research means a systematic investigation or search by means of experimentation or analysis in a field of science to acquire new knowledge; to devise and develop new products or processes; and to apply newly acquired knowledge in making improvements to existing products or processes. In some cases, expenditures to develop, test and evaluate a prototype are considered as scientific research expenditures. However, expenditures for purposes such as market research, sales promotion, quality control, or preparations of specifications are not recognized as scientific research expenditures.

In addition to the tax allowances, there are incentive programs for research and development. These are described in the "Federal Incentives to

Industry" publication in this series.

Foreign Tax Credit

A credit is allowed against the federal corporation income tax for taxes paid to a foreign government on foreign source income up to the amount of the federal income tax on such income. A credit must be calculated on income from each country.

Foreign taxes paid on income from a business carried on by a taxpayer in a foreign country in excess of the foreign tax credit available may be carried forward for five years.

Logging Tax Credit

A corporation may deduct from federal tax otherwise payable an amount equal to two-thirds of a provincial tax on income from logging operations, not exceeding six and two-thirds per cent of the corporation's income from logging operations in the province.

Investment Tax Credit

A further credit against federal tax is allowed and consists of 5 per cent of the capital cost of qualified capital investments made before July 1, 1980, in certain types of machinery, equipment and buildings used in the areas of manufacturing or processing, the production of or exploration for oil, gas or minerals, logging, farming or fishing, or the storage of grain. Both current and capital expenditures on scientific research and development are also eligible. In certain areas of Canada, the amount of the credit is increased to 7 per cent or 10 per cent of qualified expenditures.

Returns and Payment

A corporation is required to pay its tax in monthly instalments throughout its taxation year. Any balance of tax outstanding has to be paid by the last day of the second month following the close of the taxation year except for corporations still claiming the small business incentive which must pay the balance by the last day of the third month following the taxation year. The return for the year has to be filed by the last day of the sixth month following the close of the taxation year.

PROVINCIAL CORPORATION INCOME TAX

All provinces levy a tax on the income of corporations derived from operations carried on within their boundaries. The taxable income in a province is determined for provincial tax purposes on the same basis as for federal income tax in all provinces except Ontario and Quebec, and even in these two provinces the rules are similar to the federal rules.

Where a corporation carries on operations in more than one province, it must allocate its taxable income among the provinces concerned in accordance with prescribed rules which for most corporations are based on sales and wages in a province.

The rates of tax levied by the various provinces are as follows:

Province	Percentage Rate of Tax on Taxable Income
Newfoundland	14
Prince Edward-Island	10
Nova Scotia	12
New Brunswick	12*
Quebec	12
Ontario	12*
Manitoba	15*
Saskatchewan	14*
Alberta	11
British Columbia	15*

*Where a corporation is entitled to the Federal Small Business Deduction, five of the provinces provide for reduced rates of provincial tax as follows:

	Per Cent
New Brunswick	9
Ontario	9
Manitoba	13
British Columbia	12
Saskatchewan	12

It will be noted that all provinces except Prince Edward Island levy corporate income taxes in excess of the 10 per cent abatement allowed on the federal government tax.

OTHER CORPORATION TAXES

In addition to the federal and provincial corporate income taxes described above, there are some further general types of taxes which affect corporations.

One group of miscellaneous corporation taxes is the provincial taxes on paid-up capital, miles of track, land transfer, place of business, registration fees, etc. The municipalities levy property and business taxes and licence fees. These are generally referred to as "corporation taxes" as opposed to corporation income taxes and are deductible in computing income for federal income tax purposes.

The Provinces of Quebec and British Columbia impose a tax of one-fifth of 1 per cent on paid-up capital of corporations, and Ontario levies a similar tax at a rate of three-tenths of 1 per cent.

The province of Quebec has a place-of-business tax. The tax is generally $50 but is reduced to $25 when the paid-up capital is less than $25,000; in the case of loan companies, the tax is $100 when capital paid up is more than $100,000.

The provinces of Ontario, Manitoba and Alberta levy a tax based on the price at which ownership of land is transferred. In Ontario, three-tenths of 1 per cent is imposed on the purchase price up to $35,000 and three-fifths of 1 per cent on anything in excess of that amount. Additionally, a tax of 20 per cent of the purchase price is levied on certain conveyances by any person to a non-resident. In Manitoba, the rate is 1 per cent. Ontario also levies a Land Speculation Tax of 20 per cent on the increase in value after April 9, 1974, of certain designated property within the province. In Alberta, registration fees proportionate to the conveyancing services rendered are charged and, in the case of transfers and mortgages, the fees are assessed on the value of the land transferred or on the amount of the mortgage. In addition, there is an Assurance Fund fee charged on transfers and mortgages which guarantees titles in certain circumstances. British Columbia and Saskatchewan do not have a land transfer tax but have an equivalent in land title fees which are based on land value.

The property and business taxes and registration fees and licences are generally municipal levies. The property taxes are based on the assessed real value of the property (or as a percentage of the value in some centres) and assessment methods vary widely.

The business tax is levied directly on the tenant or the operator of a business. There are three general bases of assessment: a fraction of the property assessment, the annual rented value of the premises, and the area of the premises.

Special provincial corporate taxes also exist for insurance companies and primary industries and on security transfers.

All provinces impose a 2 per cent tax on the premium income of insurance companies derived from business transacted within the province.

Special taxes on specific primary industries are levied by the provinces. Taxes on the income of mining and logging operations are in addition to revenues derived by all of the provinces from rentals, royalties, stumpage dues and other charges imposed at varying rates on mineral and forest reserves. Nine of the provinces levy a tax or royalty on the income of firms engaged in mining operations.

The provinces of Quebec and British Columbia levy a tax on the income from logging operations of individuals, partnerships, associations and corporations engaged in the activity. In Quebec, the rate is 10 per cent and in British Columbia 15 per cent on net income where the net income is in excess of $10,000. If the income is $10,000 or less for a full year no logging tax is levied. In Quebec, one-third is deductible from the provincial tax. Two-thirds of the provincial tax is deductible from federal income tax in both provinces.

A Security Transfer Tax is levied on every change of ownership of any bond or share (sale, agreement for sale, transfer and assignment) effected in Quebec. This tax is imposed upon the vendor and is collected by the stock exchanges, bond dealers, transfer agents, trust companies and banks who assist in effecting the change of ownership. This tax does not apply to obligations issued or guaranteed by the federal government, the provinces, municipal corporations and school boards within the province.

OTHER LEVIES AFFECTING CORPORATIONS

Canada and Quebec Pension Plans

The Canada Pension Plan is a compulsory government-operated program under which each contributor builds up a right to a pension related to his earnings up to a certain level. This graduated benefit will supplement the universal old age security pension which is paid out of tax revenues. It operates throughout the country except in the Province of Quebec where a similar pension plan is operated by the government of the province. Both plans have disability and survivor benefits. The maximum amount contributed by an employee in 1978 was $169.20. The employee's contribution is matched by a contribution by his employer.

Unemployment Insurance

A national program of unemployment insurance operates in Canada. The program now provides benefits to qualified persons who are temporarily without work, including those unable to work because of sickness, disability or pregnancy. The program is administered by a federal commission appointed for this purpose. It is generally financed by contributions from both employees and employers. However, when the national unemployment rate exceeds a threshold calculated with reference to national unemployment rates, or in certain circumstances when the regional unemployment rate exceeds the national unemployment rate, the federal government bears the cost arising on these accounts. For 1978, the amount of an employee's contribution is calculated weekly at a rate of 1.5 per cent of insurable earnings to a maximum of $3.60 per week. The employer's rate of contribution for an employee is generally at a rate of 1.4 times the employee's premium. The employer contribution rates may be scaled down if the employer provides his employees with a sickness and disability insurance plan meeting specific standards.

As premium scales are subject to annual review, it is recommended that employers obtain current information from Revenue Canada.

Workmen's Compensation

Legislation in force in all provinces provides compensation for personal injury suffered by workmen as a result of industrial accidents. In general, these provincial statutes establish an accident fund administered by a board to which employers are required to contribute at a rate proportional to the hazards of the industry.

Other

Corporations must also consider other miscellaneous items such as withholding tax on interest (except when earned on certain forms of debt issues) and dividends paid to non-residents, sales and excise taxes, and customs duties. The first is dealt with in the applicable section of this booklet while the remaining three levies are explained in separate publications of the "Doing Business in Canada" series. Firms with foreign connections are treated separately in this booklet due to the variety of special arrangements.

PERSONAL INCOME TAXES

Federal

Every individual resident in Canada at any time in a year is liable for personal income tax on his income for the year from all sources inside or outside Canada. The determination of whether a person is resident is a question of fact, but any individual who stays in Canada for 183 days, or more, in a year is deemed to have been a resident in that year. Special rules, described later in this booklet, apply to those who reside abroad for part of the year. Income includes income from a business; wages and salary; dividends; director's fees; the interest element of annuity payments; interest; alimony received; income from estates; payments based on the use of real or personal property; one-half of capital gains; payments from certain income maintenance plans; adult training allowances; unemployment insurance benefits; amounts contributed on an employee's behalf to a public medical care plan; and scholarships, fellowships and bursaries in excess of $500.

An unincorporated taxpayer carrying on business may deduct in computing his income, in general, the same types of expenses as the corporate taxpayer, i.e. those incurred for the purpose of earning business income. Other allowable deductions permitted a taxpayer in computing his income include union and professional dues, moving expenses, child care expenses, employment expenses, and contributions to registered retirement sav-

ings plans, registered pension plans, and registered home ownership savings plans. A student is allowed to deduct tuition fees paid for recognized courses to gain a university degree or high school matriculation certificate, or to acquire a technical skill to improve his qualifications for employment or business. The employment expense deduction is 3 per cent of a taxpayer's income from an office or employment up to a maximum of $250 a year. No receipts are necessary. The employment expense deduction is not permitted to a commission salesman who may instead deduct his expenses incurred in earning commissions up to the amount of the commissions earned. A worker at a distant work site may receive tax free from his employer amounts covering expenses such as transportation, board and lodging. Child care expenses are deductible by certain taxpayers up to the least of $1,000 per child under 14, $4,000 per family, and two-thirds of the taxpayer's earned income.

An employee who is a member of a pension plan may, in a taxation year, deduct up to $3,500 in respect of his contributions to a registered pension plan. He may also deduct the amount of his contributions to a registered retirement savings plan up to an amount that when added to his pension plan contributions does not exceed the lesser of $3,500 or 20 per cent of his earned income. An employee who is not a member of a pension plan but who is or may become entitled to benefits under a plan to which his employer contributes may deduct up to the lesser of $2,500 or 20 per cent of his earned income in respect of contributions to a registered retirement savings plan. Any other individual who is not a member of a registered pension plan may deduct up to the lesser of $4,000 or 20 per cent of his earned income in respect of contributions to a registered retirement savings plan. A taxpayer may also make deductible contributions of up to $1,000 in a taxation year, with a lifetime cumulative total of $10,000, to a registered home ownership savings plan if he does not own a house.

A number of personal exemptions and other deductions are allowed in computing taxable income. In 1973, a system of indexing was introduced. Under this system the personal exemptions and tax brackets are adjusted yearly in relation to the cost of living. Thus, if the increase in a taxpayer's income in a taxation year reflects only a rise in the cost of living over a designated period, he will pay the same proportion of his income in taxes after as before his increase in income.

For the 1975 and subsequent taxation years, a taxpayer may, in computing his taxable income, deduct up to $1,000 of interest income. Commencing in 1976, this deduction has been extended to include dividends, as well as interest income, with a combined limit of $1,000. Commencing in 1977, the deduction has been further extended to permit inclusion of taxable capital gains from the disposition of Canadian securities, as well as net interest income and grossed-up dividends in the combined limit of $1,000. A taxpayer may also deduct up to $1,000 of "qualified pension income". Qualified pension income is defined to be, generally, income from a pension plan or superannuation fund. Where a taxpayer is 65 years of age or over, he may claim his $1,000 pension deduction in respect of all his private pension income including payments from a registered retirement savings plan or a deferred profit sharing plan. To the extent that a taxpayer cannot use his or her interest and dividend income deduction or pension income deduction, the taxpayer may transfer it to his or her spouse.

Other deductions in computing taxable income include the $50 per month living allowance that students, their parents or spouses, may claim for each month of full-time attendance at a post-secondary institution such as a university, community college or vocational school. In lieu of claiming deductions for charitable donations and medical expenses, an individual may claim a standard deduction of $100. Deductions for charitable contributions may not exceed 20 per cent of income. Only medical expenses in excess of 3 per cent of the taxpayer's income may be deducted.

Two types of income averaging are available to taxpayers. The first is a general averaging system which applies each year since 1973. An automatic calculation will be done by Revenue Canada when a tax return shows income 10 per cent higher than the preceding year and 20 per cent higher than the average of four immediately preceding years. The second is forward averaging which permits a taxpayer to spread the taxation of an unusual lump-sum receipt over future years by using it to purchase an immediate annuity called an "income-averaging annuity". The lump-sum receipt is deductible immediately, but the annuity payments are taxable in the years received.

The amount remaining after deducting the aggregate of exemptions and deductions from income is a taxpayer's taxable income.

Income tax on salaries and wages is deducted by the employer according to rates prescribed in deduction tables. The total of these deductions over a year should approximate 100 per cent of the total

tax payment due April 30 of the following year. The balance to be paid or refunded is calculated when a return for the year is filed. Taxpayers with more than 25 per cent of their income from sources not subject to deductions at source must pay tax by quarterly instalments.

The amount of tax is determined by applying a progressive schedule of rates to taxable income. This schedule of rates in 1978 starts at 6 per cent on the first $761 of taxable income and increases to 43 per cent on taxable income in excess of $91,260.

Currently, a federal tax reduction provides for a 9 per cent reduction in federal tax otherwise payable with a minimum of $200 and a maximum of $500.

Provincial

All provinces levy a tax on the income of individuals who reside within their boundaries or who earn business income therein. Investment income and salary and wages are allocated to the province where the individual resided on the last day of the calendar year or on his last day of residence in Canada. Where non-residents are employed or carry on business in Canada, their income for provincial income tax purposes is allocated to the province where they were employed or carried on business. The federal Income Tax Regulations outline the rules for allocating income to provinces when individuals earn business income in more than one province.

In all provinces except Quebec, the federal government administers and collects provincial personal income taxes. In these nine provinces, the provincial income tax is a certain percentage of the federal tax, which may change annually. At present, provincial rates are in the 30-40 per cent range.

The province of Quebec administers and collects its tax on individual incomes. An individual who earns income in that province may deduct 16.5 per cent of his federal tax attributable to such income. This abatement of tax is in recognition of the fact that Quebec entirely finances certain programs which are partly financed by the federal government in other provinces.

Individuals who reside in the Yukon or who reside outside of Canada but are deemed to be resident in Canada for tax purposes (such as government employees posted outside the country), must pay an additional tax of 43 per cent of their tax otherwise payable. This tax is intended to correspond in an approximate way to the income tax imposed by the provinces on their residents.

Partnerships

Partnerships are not taxed as separate entities. Instead, individuals are taxed on their share of the income of the partnership as if they had personally received the income. The computation of income, however, is made at the partnership level. Capital cost allowances are claimed by the partnership. There are special rules for partnership interests for capital gains tax purposes.

Dividend Tax Credit

An individual with taxable dividends from a Canadian corporation is entitled to a dividend tax credit. The individual increases the amount of his dividends by one-half and takes 25 per cent of the resultant figure as the allowable credit. For example, the tax credit on dividends of $400 is 25 per cent of $600 or $150. In calculating his tax, however, he must include the $600 figure in his income, not just the $400.

Foreign Tax Credit

Residents of Canada are generally taxable on their world income even though part of this income may have been taxed in a foreign country. To ensure that foreign income is not subject to double taxation, the foreign tax credit provisions allow foreign taxes to offset the Canadian tax otherwise payable on such income. Foreign taxes paid on income from a business carried on by a taxpayer in a foreign country, in excess of the foreign tax credit available, may be carried forward for five years. Commencing in 1976, the foreign tax credit on investment income of individuals (other than income from investments in real property) is limited to 15 per cent; any excess over 15 per cent will be treated as an expense.

OTHER LEVIES AFFECTING INDIVIDUALS

Canada and Quebec Pension Plans

As described in a previous section of this booklet, employees contribute to these pension plans in relation to their earnings, up to a maximim of $169.20 in 1978. Self-employed persons contribute twice this amount.

Unemployment Insurance

Most employees are covered by unemployment insurance. Details were outlined earlier in this booklet. The maximum employee contribution in 1978 is $3.60 per week. Premium scales are subject to annual review.

Hospital Insurance

A hospital insurance plan is in operation in each of the 10 provinces. In all provinces, the program is a joint federal-provincial undertaking where approximately half of the cost of hospitalization for patients who are participants under the plan is met by the federal government and the remainder by the province. (In Quebec, the share of cost carried by the federal government takes the form of a reduction of personal income tax plus cash adjustment payments.) Some provinces finance their share of the cost of the program by taxes and other provinces require the deduction of a monthly premium from the wages of their residents as a contribution or premium for the plan. In such provinces, self-employed people must pay the premium directly if they wish to be covered by the plan. In some provinces, the proceeds of a retail sales tax are earmarked in whole or in part for the support of the hospital plan.

Medicare

A national medicare plan involving the joint participation of federal and provincial governments now operates in all provinces. As in the case of hospital insurance, this program is based on a cost-sharing formula. In some provinces, premiums must be paid for this plan; in others the provincial share is raised through taxation.

CAPITAL GAINS

Legislation passed in 1971 provides that one-half of capital gains will be included in income and taxed at normal personal or corporate rates. Taxpayers may deduct one-half of capital losses against one-half of capital gains; individual taxpayers may also deduct up to $2,000 of capital losses against other income. The deductions may be made in the current year, preceding year or any number of subsequent years until losses are fully absorbed. Gains will generally be taxable and losses deductible when a taxpayer sells an asset, and also when he makes a gift of an asset, or at his death except when the gift or bequest is to his spouse, in which case the gain or loss is not accounted for until the spouse disposes of the asset.

Any gain realized by a taxpayer in selling his principal residence and up to an acre of surrounding land will be exempt. No gain realized on any item of personal property will be taxed unless the asset's selling price is more than $1,000.

There are special rules for gains on assets held at the start of the system as well as for deferral of gains in cases of destruction or expropriation, sales of property to a controlled corporation, and certain corporate reorganizations. There are also special rules for capital gains and losses realized by non-residents on the disposition of specific property known as "taxable Canadian property".

The federal estate and gift tax does not apply to the estates of persons who die or to gifts made after 1971. Succession duties and gift taxes of a generally uniform nature are now levied by three provinces (Quebec, Ontario and Manitoba).

TAX TREATMENT OF NON-RESIDENT COMPANIES

Canadian Subsidiaries of Foreign Business Firms

Where a non-resident company is carrying on business in Canada through a subsidiary company resident in Canada, the subsidiary company is treated the same as any other Canadian resident company. The total income of the subsidiary, whether earned in Canada or elsewhere, is subject to income tax in Canada. The subsidiary may claim a credit for taxes paid to a foreign country on the same basis as any other Canadian resident company.

Methods of computing income and calculating deductions are the same as those outlined in the section dealing with corporate income tax, and the rate of the income tax is the same as for any other company resident in Canada except that the small business incentive is not available to foreign-controlled corporations. Generally speaking, transactions between foreign companies and Canadian subsidiaries are required to be conducted on the same basis as would apply if the companies were not related.

Canadian Branches of Foreign Companies

Business dealings under circumstances considered to be "carrying on business in Canada"

render a non-resident company liable to Canadian income tax on profits derived from such transactions.

Non-resident companies "carrying on business in Canada" are liable to federal income tax in much the same manner as a Canadian company. The essential difference is that a non-resident company is liable to tax only on its income earned in Canada while a resident corporation is liable to tax on its total income from all sources both inside and outside Canada.

Income earned in Canada is, in principle, determined on the basis of separate accounts maintained for the business carried on in Canada by the foreign company. Normally, if the accounts of the branch are so arranged that the income of the branch can be accurately determined, the federal taxation authorities will generally accept such accounts as the basis for determining income taxable under Canadian law. However, the department may rectify the accounts produced to correct errors and omissions or to re-establish the prices or remunerations entered in the books at the value which should prevail between independent persons dealing "at arm's length".

Taxable capital gains and allowable capital losses from dispositions which are specified to be dispositions of "taxable Canadian property" are included in computing income of a non-resident company carrying on business in Canada. "Taxable Canadian property" is defined in the Income Tax Act for this purpose.

Permissible deductions for purposes of determining taxable income are almost the same for a non-resident company carrying on business in Canada as for a resident Canadian company. One exception is that dividends received by a non-resident company from Canadian companies are usually not deductible from income in arriving at taxable income.

The taxable income earned in Canada by a non-resident company is taxed at the same rate as that of Canadian resident companies except that the small business incentive will not apply. In addition, the profits remaining after deducting both federal and provincial taxes and an allowance for new, fixed and working capital investment in Canada are subject to a special 25 per cent tax. The rate of tax may be reduced by treaty. This tax tends to equalize the treatment of non-Canadian corporations that carry on business in Canada through a branch and those that carry on business through a subsidiary.

Two further items of interest to foreign companies with Canadian business activities are (1) the definition of "business" and the extended definition of "carrying on business in Canada" and (2) the resultant effect of double taxation agreements.

The Income Tax Act defines the term "business" to include a "profession, calling, trade, manufacture or undertaking of any kind whatever and includes an adventure or concern in the nature of trade but does not include an office or employment."

"Carrying on business in Canada" has an extended definition as follows: "where, in a taxation year, a non-resident person — (a) produced, grew, mined, created, manufactured, fabricated, improved, packed, preserved or constructed, in whole or in part, anything in Canada whether or not he exported that thing without selling it prior to exportation, or (b) solicited orders or offered anything for sale in Canada through an agent or servant whether the contract or transaction was to be completed inside or outside Canada or partly in and partly outside Canada, he shall be deemed, for the purposes of this Act, to have been carrying on business in Canada in the year."

Canada has double taxation agreements with Australia, Belgium, Britain, Denmark, Dominican Republic, Finland, France, Germany (FRG), Ireland, Israel, Jamaica, Japan, The Netherlands, New Zealand, Norway, Pakistan, The Philippines, The Republic of South Africa, Sweden, Switzerland, Singapore, Trinidad and Tobago and the United States. These agreements provide that an enterprise of one of the contracting countries may be taxed by the other country only on the industrial and commercial profits allocable to its permanent establishment in the latter country. "Permanent establishment" may include a mine or other place of extraction of natural resources, a branch, an office, a factory, a workshop, an agency and other fixed places of business, but not subsidiaries.

Where an enterprise of a treaty country carries on business in Canada through an employee or agent established here, or who has general authority to contract for his employer or principal, it is generally provided in the treaty that such an enterprise is deemed to have a permanent establishment in Canada and is, therefore, liable to Canadian taxation. However, the fact that an enterprise of one of the contracting countries has business dealings in Canada through a commission agent, broker or other independent agent, or maintains in Canada an office used solely for the purchase of merchandise, is not held to mean that the non-resident company has a permanent establishment in Canada.

TAX TREATMENT OF NON-RESIDENT PERSONS

For tax purposes, non-resident persons may be divided very broadly into four main classes: (1) non-resident persons carrying on business in Canada; (2) non-resident persons working in Canada; (3) non-resident persons who disposed of taxable Canadian property; (4) non-resident persons receiving income from other Canadian sources.

Carrying on Business in Canada

A non-resident taxpayer other than a corporation is liable to Canadian income tax for business dealings in Canada. Taxable income earned in Canada by a non-resident partner or sole proprietor is considered to be the part of his income for the year that may reasonably be attributed to the business carried on by him in Canada, minus applicable deductions.

A non-resident individual who is employed in Canada or who carried on business in Canada, either as a sole proprietor or a member of a partnership, is subject to tax at the graduated rates only on his taxable income attributable to the employment or business in Canada and on any taxable capital gains from dispositions of "taxable Canadian property". If he has investment income from Canadian sources not related to the business carried on in Canada, this investment income is not combined with the income from employment or carrying on business in Canada but is subject to the tax on non-residents withheld under a separate part of the Act. (This same rule applies to non-resident corporations carrying on business in Canada).

Working in Canada

A person who "sojourned in Canada in a taxation year for a period of, or periods the aggregate of which is, 183 days or more" is deemed to be a resident of Canada and is taxable on income from all sources both within and without Canada. A credit is allowed for taxes paid to a foreign government on income earned in such other country.

A non-resident who is employed in Canada is liable to Canadian income tax on that part of his income received for work performed in Canada. Such income is taxable in a manner similar to the taxation of income in the hands of resident Canadians. This person is allowed to claim a pro rata portion of a full year's personal exemption.

Liability may not arise in all cases, however. Exceptions are to be found in the double taxation agreements which Canada has concluded with many other countries.

Under these agreements, there are certain situations where the earnings of an employee temporarily resident in Canada are not subject to income tax in this country. However, Revenue Canada must have proof that the individual is exempt from such liability before permission is given to waive the deduction of tax at the source. Unless permission has otherwise been obtained, an employer is required to make authorized deductions on a monthly basis and forward the amounts so collected to the Receiver General for Canada. The tax deducted at the source and paid in by the employer will be refunded to the employee when he proves that he is entitled to exemption.

Taxable Capital Gains

Taxable income of a non-resident person for Canadian tax purposes includes taxable capital gains less allowable capital losses (one-half of the capital gain or one-half of the capital loss) on disposition of "taxable Canadian property". "Taxable Canadian property" is defined in the Income Tax Act.

Taxable income arising from this source is subject to the normal graduated rates of Canadian income tax. There are provisions in the Act under which a person acquiring such property from a non-resident may become liable to withhold from the purchase price, or otherwise pay, amounts in respect of this tax if a certificate procedure which is available is not followed.

Provisions of international tax treaty may modify the effect of these provisions.

Receiving Income from Other Canadian Sources — Withholding Tax

Corporations or individuals resident outside Canada who receive income from Canadian sources are required to pay by deduction at source a withholding tax of 25 per cent (unless a lower rate is provided by treaty) on payment of amounts credited to their accounts in respect of dividends, interest, income from a trust or estate, rents, alimony, royalties or similar payments, including payments (a) for the use in Canada of property; (b) for an invention used in Canada; (c) for any trade name, franchise, design or other thing whatsoever used in Canada;

(d) for certain payments for information concerning industrial, commercial or scientific experience; (e) for certain payments for services of an industrial, commercial or scientific character; and (f) for a management or administration fee or charge as defined in the Income Tax Act. Pensions and similar payments to non-residents are subject to withholding taxes at the general rate. Old Age Security pensions and Canada or Quebec Pension Plan benefits are exempt. A non-resident may elect to file a Canadian tax return, to calculate his tax on his Canadian pension and other similar income at graduated personal rates and thereby obtain a refund of excess withholding tax if appropriate.

Interest on government and government-guaranteed bonds is exempt from withholding tax for securities issued before 1983. There is a special exemption for interest payable to foreign charitable organizations, pension funds and similar institutions abroad. To qualify under this exemption, non-resident persons must be exempt from tax imposed by their country of residence. The rate of withholding tax on dividends paid by corporations having the required degree of Canadian ownership is five percentage points less than the general withholding rate. For details concerning the meaning of a "degree of Canadian ownership", see Appendix "A".

Until 1976, Canadian residents making payments as described in the first paragraph of this section to a non-resident company or individual had to deduct 10 per cent or 15 per cent, depending on circumstances, from every such payment at the time the payment was made or credited to the foreign party. In 1976 and thereafter, the corresponding rates are 20 or 25 per cent. The amount deducted must be remitted to the Receiver General for Canada. Whenever an agent of a non-resident corporation or individual receives payments from which the tax deduction has not been made, he is required to make such deduction before paying over to his principal.

FOREIGN TAXES ON INCOME EARNED IN CANADA

Apart from measures of relief from double taxation as found in the agreements which Canada has concluded with other countries, there are also specific provisions written into the income tax laws of these and most other countries with which a non-resident investor in a Canadian enterprise may be concerned. While these provisions vary from country to country, it can be generally stated that Canadian taxes on income earned by foreign investors are normally available as a full or partial credit against taxes payable thereon in the investor's country of residence. In some cases, Canadian tax payments can be considered as a deductible expense in calculating the investor's tax liability in his country of residence.

In all cases, investors are well advised to discuss the subject of tax liability on income earned abroad with tax authorities in their country of residence.

APPENDIX "A"

DEGREE OF CANADIAN OWNERSHIP

The following is an abridged version of the actual requirements which must be met if a company is to be regarded as having a "degree of Canadian ownership".

1. The company must be a resident of Canada.
2. (a) No less than 25 per cent of the company's issued and outstanding voting shares and no less than 25 per cent of the equity share capital of the company must be owned in Canada (by individuals and/or by Canadian-controlled companies).

   OR

   (b) A class or classes of voting shares and a class or classes of equity shares representing no less than 50 per cent of the equity share capital of the company must be listed on a Canadian stock exchange and no more than 75 per cent of the equity share capital, nor more than 75 per cent of the voting shares must be owned abroad by one non-resident person or related persons.
3. At least 25 per cent of the directors of the company must be resident in Canada.

To qualify as having a degree of Canadian ownership in a particular taxation year, a company must have met requirements described above throughout any 60-day period in the 120-day period commencing 60 days before the first day of the year.

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